



STUART INVESTMENT MANAGEMENT LIMITED

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The markets were again positive over those of August with the Dow Jones Index rising 2.28% and the TSX up 4.85% over the month, closing above the 11,000 mark after peaking at 11,648. The S&P 500, the NASDAQ Index, and the Value Line Index recorded gains of 3.57%, 5.64% and 5.96% respectively while the Canadian Dollar rose 2.22%.

In our opening comment in last month's Market Commentary, we predicted that the auto market would reverse itself in September after the "Cash for Clunkers" program expired. This has proven to be the case for all manufacturers, with the domestic "Big Three" suffering the most. The **Ford Motor Company** is entering into very testy negotiations with the Canadian Auto Workers Union, trying to lower its labour costs in Canada to at least match the newly re-negotiated labour costs in its US plants. The CAW is demanding that Ford keep two uneconomic plants open in Windsor and St. Thomas in return. We feel that the CAW is trying to negotiate from a very weak position. Ford maintains that they are now at a major competitive disadvantage to **General Motors Corp.** and **Chrysler Inc.**, because they did NOT declare bankruptcy and could not lower their interest, distribution, pension and labour costs unilaterally, nor did they take the cheap government loans to keep them going.

A very significant huge new issue of US\$500 Billion of International Monetary Fund 5-year Bonds was announced in early September, to finance lending to help economies battered by the global downturn. Very significantly, the Chinese government subscribed for the equivalent of 10% of the issue (approximately US\$50 billion worth), but elected to pay in their own currency – a grand total of 341.2 billion Yuan. The Chinese are hoping it will be used to facilitate Yuan loans and

currency swap deals, similar to the agreements they have already signed with Argentina, South Korea, Malaysia, Indonesia and Belarus. This will "help to internationalize the Yuan" and turn it into an alternative "reserve currency for other emerging markets." China is also demanding a bigger say in the affairs of the IMF and this loan will boost its standing with the Fund. This could result in the Yuan becoming a very credible threat to the US Dollar as the world's primary reserve currency over the longer term.

Other events in the month were the Polish government's solemn Remembrance Ceremony of the day Nazi Germany attacked its Westerplatte Peninsula, starting the Second World War, 70 years ago. The Iranian government revealed the existence of a second, previously unacknowledged, uranium enrichment plant. This caused strong condemnation from most of the Western World, and surprisingly even brought mild reproach from both the Russian and Chinese governments. A bomb blast badly damaged the Athens Stock Exchange, shortly after a smaller bomb exploded outside a government building in Thessaloniki. Luckily, both attacks were preceded by a short warning call, and only one security guard was slightly wounded.

South East Asia had a very bad month with a 7.0 magnitude earthquake in Indonesia killing 42 people early in the month, and a deadly typhoon slammed into Vietnam and the Philippines killing a further 278 people and flooding towns and villages. The city of Manila was 80% flooded, affecting most of its 15 million inhabitants with over 1.9 million people affected, abandoning 375,000 homes! More importantly the typhoon destroyed 180,000 tons of paddy rice or 3% of the fourth quarter output, leading to higher prices in the future. Later in the month a powerful tsunami, triggered by an 8.3 magnitude underwater earthquake, killed over 100 people in Samoa and wiped out a large portion of its tourist infrastructure. The same day another 7.6 magnitude earthquake struck the city of Padang, Indonesia, causing extensive damage. Padang is on the "Ring of Fire" and is 373 miles northwest of the

epicenter of the huge quake that killed 232,000 people in the huge tsunami of 2004.

On a more positive note, Japan swore in a new government after more than 50 years of nearly unbroken rule by the Conservatives, who have ruled with the worst of nepotistic practices. The Bank of Japan upgraded its view of the state of the Japanese economy after Japan posted its seventh straight monthly trade surplus due to a recovery in overseas markets, but the Bank left interest rates unchanged at 0.1%!

Finally, Prince Harry turned 25 and hence qualified for his inheritance from his late mother Princess Diana's estate, estimated to be in excess of \$15 million. Harry was unable to celebrate his birthday and his windfall, as he was in the midst of intensive training as a helicopter pilot with his army unit.

IN OUR BACKYARD

In Canada, the economy continued to outperform the US economy, but not without some areas which are suffering as a result of the global financial meltdown. Job losses in August were lighter than expected with a Canadian unemployment rate of 8.7%, significantly lower than the US rate of almost 9.8%. Canadian manufacturing sales grew more than expected at 5.5% which is the largest gain since August 1998, with 15 of 21 manufacturing sectors reporting gains. Needless to say, Canadian consumer confidence rose for the seventh consecutive month and the housing market seems to be turning around slowly, helped by historically low mortgage rates, according to the Conference Board of Canada.

One of SIML's old favourite companies **Teck Resources Ltd.** rebounded from its March low of \$3.35 to its current level of \$28.80 after successfully managing to refinance a large portion of the \$14 billion in debt it took on to purchase another old SIML favourite, **Fording Coal** in the summer of 2008. We elected to take some profits from Teck as we felt it had gotten ahead of itself, so we sold out most of our positions recently. Apparently the CEO of Teck also agreed with us, as he recently sold 190,000 of his shares for approximately \$5.2 million. Another old Canadian chestnut, **EnCana Corp.** revived its May 2008 plan to split itself into an oil sands producer and a "pure-play" natural gas producer, as management felt the company was not getting full credit for its assets in the current negative market for natural gas.

In a move to expand its US wealth management division, the **Royal Bank of Canada** has agreed to buy **JP**

Morgan Chase & Co's investment advisor servicing business, but terms were not disclosed.

THE ROAD TO RECOVERY?

A steep dive in China's stock markets started an early September sell off on the Dow. Luckily the US markets recovered over the month as it was reported that the service sector was "showing signs of improvement", while it was still shrinking! It just wasn't shrinking as fast as it was before! The services sector represents about 80% of US economic activity and includes businesses such as banks, airlines, hotels and restaurants. Job losses in the USA were "only" 216,000 in August, down from a peak of 700,000 a month at the beginning of 2009! This heralds the beginning of a long, jobless recovery similar to what we saw in the 80's.

The US deficit hit an almost incomprehensible \$1.38 TRILLION in August with one more month in the budget year. The forecast for the full year is currently \$1.58 trillion, versus a previous record deficit of \$454.8 billion in 2008 - almost 3.5 times greater than the previous all-time record! This came almost exactly on the anniversary of Lehman Brothers collapsing and the bailout of AIG by the US government. To exacerbate the deficit numbers, the Obama administration is determined to initiate additions to the nation's \$2.5 trillion health care system, requiring most people to purchase insurance coverage for health care. This 10 year "fix" would cost the equivalent of \$856 billion, all to be added to the astronomical deficit numbers alluded to above. To worsen the 2009-2010 deficit, the Obama administration has extended unemployment benefits by 13 weeks in certain states with high unemployment. The only positive from this is that the number of unemployment claims dipped in the week ended September 12th, 2009 but the number of continuing claims continues to grow.

Some signs of improvement are apparent as lean inventories of new homes helped US housing starts rise to a 9-month high in August to an annual adjusted rate of 598,000 homes, and the number of bank repossessions fell to 358,471! **General Motors** restored 3,000 jobs at its plants in Kansas, Indiana and Michigan and **General Electric Company** shares are now back to approximately where they were at the end of 2008. The increase in share prices since the nadir in March of 2009 have helped US household wealth grow by \$2 trillion, but consumers are not spending this newfound "wealth", they are merely reducing their indebtedness.

On a final note, following up from our last Market Commentary on the Kennedy family's "mensis horribilus", it appears that Senator Edward Kennedy's

seat in the US Senate will be passed over to the former Democratic Party Chairman, Paul G. Kirk, until the next election. His appointment significantly gives President Obama the critical 60th vote needed in the US Senate to pass the health care bill. Who said that only in North Korea, India, Syria and Cuba did they have hereditary political dynasties?